No. 09-1339

In the Supreme Court of the United States

NESTLE PURINA PETCARE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner's claimed deductions under 26 U.S.C. 404(k) for amounts that it paid to its employee stock ownership plan trust to redeem shares of its stock, which amounts were in turn distributed by the trust to plan participants, were barred by 26 U.S.C. 162(k)(1).

2. Whether the court of appeals correctly held that the narrow exception to 26 U.S.C. 162(k)(1) set forth in 26 U.S.C. 162(k)(2)(A)(iii) does not apply in this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A8) is reported at 594 F.3d 968. The opinion of the Tax Court (Pet. App. A9-A38) is reported at 131 T.C. 29.

JURISDICTION

The judgment of the court of appeals was entered on February 9, 2010. The petition for a writ of certiorari was filed on April 30, 2010. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Internal Revenue Code, a corporation generally is not allowed a deduction for dividends paid to its shareholders. Under 26 U.S.C. 404(k)(1), however, certain payments qualifying as "applicable dividend[s]" that are paid by a corporation to its employee stock own-

ership plan (ESOP) are deductible. To be deductible, the "applicable dividends" must be (1) paid in cash to plan participants or their beneficiaries; (2) paid to the plan and distributed in cash to participants or their beneficiaries not later than 90 days after the close of the plan year in which they are paid; or (3) used to make payments on a loan that financed the ESOP's acquisition of the applicable securities. 26 U.S.C. 404(k)(2). Under 26 U.S.C. 162(k)(1), however, "no deduction otherwise allowable shall be allowed * * * for any amount paid or incurred by a corporation in connection with the reacquisition of its stock."

2. In 1989, petitioner amended its employee retirement plan to add an ESOP. A trust was created to hold assets of petitioner's retirement plans. The trust was divided into several funds, one of which, the ESOP Preferred Stock Fund (ESOP Trust), held all the ESOP's assets and was governed by a separate trust agreement. Pet. App. A2, A11; Pet. C.A. App. 43-45.

In connection with the creation of the ESOP, petitioner authorized the issuance of a new class of convertible preferred stock, and all contributions to the ESOP were required to be invested in that preferred stock. Pet. C.A. App. 8-9, 49, 56. Although the ESOP maintained an account designating each employee's ESOP holdings, shares of the preferred stock could only be issued in the name of the ESOP trustee, and the ESOP Trust was the legal owner of all shares held by the ESOP. *Id.* at 9, 43, 51. The managers of petitioner's employee retirement plan, together with petitioner's officers and directors, created a committee whose members served as fiduciaries responsible for administration of the ESOP Trust. Pet. App. A11; Pet. C.A. App. 46-48. Under the ESOP Trust agreement, the trustee was re-

quired to make distributions from the ESOP Trust to plan participants at such times and in such amounts as the committee directed. Pet. App. A11-A12; Pet. C.A. App. 46-48.

Upon the termination of their employment, employees were required to end their participation in the ESOP. Pet. App. A2. All the preferred stock allocated to the former employee's accounts was required to be converted to cash or to petitioner's common stock, or to a combination thereof, and paid over to the former employee or invested on his behalf in an annuity or another fund. *Ibid.*; Pet. C.A. App. 59-60. The ESOP trustee, as holder of the preferred stock, could, in its discretion, require petitioner to redeem shares of preferred stock at any time, but only to the extent necessary (i) to make a distribution to, or satisfy an investment election by, a participant in the ESOP or (ii) to pay principal or interest on the ESOP loan. *Id.* at 63, 85-86. The ESOP Trust also had the option to satisfy its obligation to make distributions to plan participants out of cash otherwise available to it, without requiring petitioner to redeem stock. Pet. App. A13; Pet. C.A. App. 64-65, 72.

For plan years 1989 through 1993, the ESOP Trust made distributions to terminating participants using cash otherwise available to it. Pet. App. A14. In August 1994, petitioner was first called upon to redeem stock from the ESOP Trust, and it redeemed 28,224 shares for $3,128,066, which the ESOP Trust distributed to plan participants by the end of the plan year. *Ibid.* In February 1995, petitioner redeemed another 56,645 shares of preferred stock from the ESOP Trust for $6,277,965, and again the ESOP Trust distributed all proceeds to participants within the plan year. *Ibid.* During both of

those periods, the ESOP Trust also made distributions from cash otherwise available. *Ibid.*

Petitioner filed consolidated corporate income tax returns for its taxable years ending September 30, 1994 and 1995, but it did not then claim deductions for its payments to redeem stock from its ESOP Trust. Pet. App. A14. The Commissioner of Internal Revenue subsequently issued a notice of deficiency to petitioner with respect to issues unrelated to the ESOP. *Ibid.*

3. Petitioner filed a Tax Court petition challenging the notice of deficiency. Pet. App. A14. In 2003, while the case was pending, the Ninth Circuit decided *Boise Cascade Corp.* v. *United States*, 329 F.3d 751, in which it upheld Boise Cascade's claim that the company was entitled to deductions under 26 U.S.C. 404(k) for payments made to redeem preferred stock from its ESOP trust. Petitioner then amended its Tax Court petition, claiming that it too was entitled to a deduction for the amounts that it had paid to redeem stock from its ESOP trust. Pet. App. A14-A15, A18.

After the parties settled the other issues in the case, the Tax Court granted summary judgment to the Commissioner, holding that 26 U.S.C. 162(k)(1) barred the claimed deductions. Pet. App. A9-A40. In reaching that conclusion, the court declined to follow *Boise Cascade*, stating that it viewed the Ninth Circuit's reasoning in that case as "facially inconsistent." *Id.* at A24. The court explained that the Ninth Circuit had agreed with Boise Cascade that its redemption payments to the ESOP Trust and the distribution payments from the ESOP Trust to employee-participants were "linked in an integrated transaction, so that the transaction fits within one of the transactions permissible under section 404(k)—a dividend payment from a corporation to a plan

and a distribution of those proceeds to departing employees." *Ibid.* In holding that the deduction was not barred by 26 U.S.C. 162(k)(1), however, the *Boise Cascade* court had then concluded that the payment in redemption of stock and the distribution to ESOP participants were "in fact not connected for purposes of section 162(k)." Pet. App. A24. The Tax Court observed that petitioner "seems to want it both ways; it relies on the integrated form of the transaction to justify a section 404(k) deduction only to deny that form in another context." *Ibid.*

The Tax Court further concluded that petitioner had framed the Section 162(k) issue incorrectly by characterizing the question as whether the distribution payment from the ESOP Trust to plan participants was "in connection with" a redemption. Pet. App. A24-A25. The court explained that Section 162(k) bars "otherwise allowable" deductions that are made in connection with a repurchase of stock, and here the only "otherwise allowable" deduction was the Section 404(k) deduction for "applicable dividends." *Id.* at A24-A28. Thus, the Tax Court concluded, the proper question for Section 162(k) purposes was whether the otherwise deductible "applicable dividends" that the petitioner had paid were "in connection with" a repurchase of stock. *Id.* at A25. The court explained that the distribution payments from the ESOP Trust to plan participants, standing alone, could not be "applicable dividends" because under Section 404(k), an applicable dividend must involve both a payment from a corporation and a distribution of that payment to departing employees. *Id.* at A26-A27. The court added that the distribution payments from the ESOP Trust could not qualify as the deductible applicable dividend to which Section 162(k) analysis should be

applied because "a dividend is defined as a payment by a corporation to its shareholders" and the distributions were not paid by petitioner. *Id.* at A27.

4. The court of appeals affirmed. Pet. App. A1-A8. The court relied on its decision in *General Mills, Inc.* v. *United States*, 554 F.3d 727 (8th Cir. 2009), which was issued after the Tax Court decision in this case, and which employed essentially the same reasoning as the Tax Court. Pet. App. A4. The court also noted that the Third Circuit had recently agreed with the decision in *General Mills* and had declined to follow *Boise Cascade*. *Ibid.* (citing *Conopco, Inc.* v. *United States*, 572 F.3d 162, 166-167 (3d Cir. 2009)). Finally, the court of appeals rejected petitioner's alternative argument that the bar of Section 162(k)(1) was lifted in this case by the exception in 26 U.S.C. 162(k)(2)(A)(iii), which provides that Section 162(k)(1) shall not apply to any deductions for "dividends paid" within the meaning of 26 U.S.C. 561. The court explained that the deductions claimed by petitioner were for "applicable dividends" under Section 404(k) and not for "dividends paid" under Section 561. Pet. App. A6-A7.

ARGUMENT

The court of appeals correctly held that 26 U.S.C. 162(k) precluded petitioner from claiming a tax deduction for amounts paid to redeem shares of its stock from its employee stock ownership plan. The decision below does not conflict with any decision of this Court, and it accords with a decision of the Third Circuit.

The court of appeals' decision in this case conflicts with the Ninth Circuit's ruling in *Boise Cascade Corp.* v. *United States*, 329 F.3d 751 (2003). After the Ninth Circuit issued its decision in *Boise Cascade*, however, the

Treasury Department promulgated regulations clarifying that Section 162(k) bars deductions under 26 U.S.C. 404(k) for payments to redeem a corporation's stock from its ESOP trust under the circumstances of this case. In light of those regulations and the rejection of *Boise Cascade*'s reasoning by both the Third and Eighth Circuits, there is a substantial likelihood the Ninth Circuit will reconsider its position in a future case, making this Court's intervention unnecessary. Further review therefore is not warranted.

1. The court of appeals correctly held that, even if petitioner's payments to its ESOP trust qualified as "applicable dividends" under Section 404(k), any deduction otherwise allowable under that section for such dividends is barred by Section 162(k)(1). As the court explained in its earlier decision in *General Mills, Inc.* v. *United States*, 554 F.3d 727 (8th Cir. 2009), a corporation's distribution to its ESOP trust to redeem stock, and the ESOP Trust's distribution of those funds to plan participants, are both necessary to give rise to the "applicable dividends" for which the corporation may claim a deduction under Section 404(k). *Id.* at 729-730; see Pet. App. A26 (explaining that "the applicable dividend as defined [by Section 404(k)(2)(A)] requires both a payment from a corporation and a distribution of that payment to departing employees"). For that reason, both distributions are "in connection with" the redemption of stock, and Section 162(k)(1) therefore bars the claimed deductions. *General Mills*, 554 F.3d at 729-730; see 26 U.S.C. 162(k)(1) ("[N]o deduction otherwise allowable shall be allowed * * * for any amount paid or incurred by a corporation in connection with the reacquisition of its stock.").

The Ninth Circuit reached a contrary conclusion in *Boise Cascade* because it considered only the distribution from the trust to the plan participants—in isolation from the corporation's payment to the trust—in deciding whether Section 162(k)(1) applied. 329 F.3d at 757-758. Focusing on the trust's distribution payment standing alone, the *Boise Cascade* court concluded that Section 162(k) did not operate to bar the deduction because that distribution payment was not "in connection with" a redemption of stock. *Id.* at 757. In making its antecedent determination that there was an "applicable dividend" deductible under Section 404(k)(1), however, the Ninth Circuit treated the corporation's distribution of dividends to its ESOP trust and the trust's distribution of the proceeds to plan participants as a single integrated transaction. *Id.* at 754-756. In this case, the Tax Court emphasized that internal inconsistency in declining to adopt the reasoning of *Boise Cascade*. See Pet. App. A23-A24. As the Eighth Circuit observed in *General Mills*, Section 404(k) connects the two steps giving rise to a deductible "applicable dividend," so it cannot be the case "that one step is 'in connection with' the stock redemption, while the other step is not." 554 F.3d at 729-730.[1]

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[1] The Conference Report accompanying the bill that became Section 162(k) stated that "the phrase 'in connection with [a] redemption' is intended to be construed broadly." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. Pt. 2, 168 (1986) (*1986 House Report*); see *General Mills*, 554 F.3d at 730; *UNUM Corp.* v. *United States*, 130 F.3d 501, 512 n.12 (1st Cir. 1997) (concluding that Section 162(k)(1)'s plain language sweeps broadly), cert. denied, 525 U.S. 810 (1998). And the House and Senate Reports clarified that "while Congress enacted § 162(k)(1) in response to corporate taxation strategies in takeover bids, '[t]his provision is not limited to hostile takeover situations but applies to any corporate stock redemption.'" *General Mills*, 554 F.3d at 730 (quoting S. Rep. No. 313,

Petitioner's criticisms of the decision below (Pet. 11-23) largely repeat the errors in the Ninth Circuit's analysis. Because the amount petitioner seeks to deduct is the very amount it paid to reacquire its stock from the ESOP Trust, the payment was made "in connection with the reacquisition of [petitioner's] stock" under any natural understanding of that phrase. The court of appeals therefore correctly held that Section 162(k) barred petitioner from claiming a deduction for that payment.

2. The current circuit conflict is of limited ongoing significance because new regulations have clarified the proper interpretation of Section 162(k). Those regulations, which apply to payments made on or after August 30, 2006, provide that Section 404(k) deductions are not permitted for "[p]ayments to reacquire stock held by an ESOP * * * used to make benefit distributions to participants." Treas. Reg. § 1.404(k)-3; see Treas. Reg. § 1.162(k)-1. The new regulations reflect the long-standing position of the Treasury Department, see Rev. Rul. 2001-6, 2001-1 C.B. 491, and they are entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 842-845 (1984). See *Atlantic Mut. Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389 (1998).

This Court has held that a court must defer to a regulatory interpretation of a statute, even if it is inconsis-

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99th Cong., 2d Sess. 223 (1986); H.R. Rep. No. 426, 99th Cong., 1st Sess. 249 n.15 (1985)). Nor, contrary to the view of the Ninth Circuit, does the legislative history indicate that Congress intended Section 162(k)(1) to bar deductions only for expenditures "necessary and incident" to stock redemptions. See *Boise Cascade*, 329 F.3d at 758. Rather, properly read, the legislative history "restates the clear rule that § 162(k)(1) disallows 'amounts paid to repurchase stock,' and in addition, all other necessary or incidental expenses." *General Mills*, 554 F.3d at 730; see *Conopco, Inc.* v. *United States*, 572 F.3d 162, 168 n.7 (3d Cir. 2009).

tent with a prior judicial decision, unless the prior decision was based on the unambiguous statutory language. *National Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 982-985 (2005). Contrary to petitioner's suggestion (Pet. 23 n.11), although the court in *Boise Cascade* adopted an interpretation of Section 162(k) different from that set out in the new regulations, the court did not hold that its position was compelled by unambiguous statutory language. To the contrary, the court acknowledged that the government's construction represented a "possible sense" of the phrase "in connection with," and it adopted a different interpretation only because, in its view, "the legislative history indicate[d] a narrower construction." 329 F.3d at 757. Accordingly, if the issue arises in a future case, the Ninth Circuit should defer to the authoritative construction of Section 162(k) that is now set out in the regulations, thus resolving the disagreement among the circuits without the need for this Court's intervention.

3. Petitioner argues (Pet. 23-26) that review by this Court is necessary to instruct the Eighth Circuit that it was required to adhere to the Ninth Circuit's decision in *Boise Cascade*. That contention lacks merit. Because "Congress has created multiple and co-equal intermediate federal appellate courts, each with an equal power and duty to decide the cases properly brought before it," its design necessarily contemplates "the possibility of a considered difference in views among the circuit courts on a given question." *Washington Energy Co.* v. *United States*, 94 F.3d 1557, 1561 (Fed. Cir. 1996); see *In re Korean Air Lines Disaster of Sept. 1, 1983*, 829 F.2d 1171, 1176 (D.C. Cir. 1987) (R.B. Ginsburg, J.) ("[E]ach [federal court] has an obligation to engage independ-

ently in reasoned analysis."), aff'd *sub nom. Chan* v. *Korean Air Lines, Ltd.*, 490 U.S. 122 (1989).

Nor is there merit to petitioner's suggestion (Pet. 24-25) that principles of collateral estoppel should bind the government once it has litigated an issue in one circuit. The Court emphatically rejected that argument in *United States* v. *Mendoza*, 464 U.S. 154 (1984). The Court in *Mendoza* explained that a "rule allowing nonmutual collateral estoppel against the Government * * * would substantially thwart the development of important questions of law by freezing the first final decision rendered on a particular legal issue," thereby "depriv[ing] this Court of the benefit it receives from permitting several courts of appeals to explore a difficult question before this Court grants certiorari." *Id.* at 160 (citations omitted).

4. Petitioner contends (Pet. 27-32) that, even if its claimed deductions would otherwise be barred by Section 162(k)(1), this case is governed by the exception in Section 162(k)(2)(A)(iii), which makes Section 162(k)(1) inapplicable to "deduction[s] for dividends paid (within the meaning of section 561)." As the court of appeals explained, however, the exception in Section 162(k)(2)(A)(iii) is limited by its terms to the deduction for "dividends paid" within the meaning of Section 561. Pet. App. A6. Section 162(k)(2)(A)(iii) does not apply to the deductions for "applicable dividend[s]" claimed by petitioner under Section 404(k).

Section 561 itself does not provide a deduction, but rather contains a definition of the phrase "deduction for dividends paid," which is relevant only for certain specialized purposes listed in Section 1.561-1(a) of the Treasury Regulations. The court below correctly concluded that the dividends referred to in Sec-

tion 162(k)(2)(A)(iii) do not include "applicable dividends" under Section 404(k). Pet. App. A6-A7.[2] Because the decision below is correct and no circuit conflict exists on the issue, this Court's review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[2] The legislative history of Section 162(k) confirms that Congress did not intend the exception now codified in Section 162(k)(2)(A)(iii) to extend to "applicable dividends" under 26 U.S.C. 404(k). See *1986 House Report* 168 (1986) (explaining that the exception applies to "amounts constituting dividends for purposes of the accumulated earnings, personal holding company, and foreign personal holding company taxes, and for purposes of the regular income tax in the case of regulated investment companies and real estate investment trusts").